

# OPEN MEETING ITEM

## ORIGINAL



COMMISSIONERS  
JEFF HATCH-MILLER - Chairman  
WILLIAM A. MUNDELL  
MIKE GLEASON  
KRISTIN K. MAYES  
GARY PIERCE

### ARIZONA CORPORATION COMMISSION



0000067204

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Arizona Corporation Commission  
**DOCKETED**

FEB 23 2007

DATE: FEBRUARY 23, 2007  
DOCKET NOS: E-04204A-06-0493 and G-04204A-06-0493  
TO ALL PARTIES:

DOCKETED BY	nr
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Enclosed please find the recommendation of Administrative Law Judge Jane Rodda.  
The recommendation has been filed in the form of an Order on:

UNS ELECTRIC, INC. and UNS GAS, INC.  
(FINANCE)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and ten (10) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00 p.m.** on or before:

MARCH 5, 2007

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Working Session and Open Meeting to be held on:

MARCH 13, 2007 AND MARCH 14, 2007

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250. For information about the Open Meeting, contact the Executive Secretary's Office at (602) 542-3931.

BRIAN C. McNEIL  
EXECUTIVE DIRECTOR

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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 **COMMISSIONERS**

3 JEFF HATCH-MILLER, Chairman  
4 WILLIAM A. MUNDELL  
5 MIKE GLEASON  
6 KRISTIN K. MAYES  
7 GARY PIERCE

8 IN THE MATTER OF THE APPLICATION OF  
9 UNS ELECTRIC, INC. AND UNS GAS, INC. FOR  
10 A FINANCING ORDER AUTHORIZING  
11 VARIOUS FINANCING TRANSACTIONS.

DOCKET NO. E-04204A-06-0493  
DOCKET NO. G-04204A-06-0493

12 DECISION NO. \_\_\_\_\_

13 **ORDER**

14 Open Meeting  
15 March 13 and 14, 2007  
16 Phoenix, Arizona

17 **BY THE COMMISSION:**

18 Having considered the entire record herein and being fully advised in the premises, the  
19 Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

20 \* \* \* \* \*

21 **FINDINGS OF FACT**

22 1. On July 28, 2006, UNS Electric, Inc. ("UNS Electric") and UNS Gas, Inc. ("UNS  
23 Gas") (collectively "Applicants") filed a joint application with the Commission requesting  
24 authorization for various financing transactions.

25 2. The Applicants seek authorization for UNS Electric to refinance and increase its long-  
26 term debt, for the Applicants to extend and increase the amount of their joint revolving credit facility,  
27 for pre-approved authority to subsequently renew their joint revolving credit facility, and for UNS  
28 Electric to enter into security agreements granting liens on some or all of its properties.

3. On October 16, 2006, Applicants filed affidavits of publication attesting that public  
notice of the application was made in the *Arizona Daily Star* and Lake Havasu's *Today's News-  
Herald* on August 28, 2006; in the *Arizona Republic*, the *Kingman Daily Miner*, and the *White*

1 *Mountain Independent* on August 29, 2006; the *Holbrook Tribune-News*, the *Prescott Courier*, and  
2 the *Sedona Red Rock News* on August 30, 2006; the *Nogales International* on September 19, 2006;  
3 the *Winslow Mail* on September 20, 2006; the *Verde Independent* on September 26, 2006; and the  
4 *Williams-Grand Canyon News* on September 29, 2006.

5 4. On December 15, 2006, Commission Utilities Division Staff ("Staff") filed its Staff  
6 Report, recommending conditional approval.

7 5. The Applicants did not file a Response or comments to the Staff Report.

8 6. The Applicants are wholly owned subsidiaries of Unisource Energy Services, Inc.,  
9 and sister companies of Tucson Electric Power Company ("TEP"). UNS Electric serves  
10 approximately 91,000 customers in Mohave and Santa Cruz counties and maintains a service office in  
11 Kingman. UNS Gas serves approximately 142,000 customers in Mohave, Yavapai, Coconino,  
12 Navajo and Santa Cruz Counties and maintains a service office in Flagstaff.

13 Long-term Debt

14 7. UNS Electric seeks to issue \$100 million in long-term debt for the purpose of  
15 refinancing \$60 million of existing interest-only long-term debt ("Senior Notes") that matures in  
16 August 2008; and to provide long-term capital to refinance capital improvements that are first  
17 financed with a revolving credit facility. UNS Electric is seeking authority to refinance the Senior  
18 Notes a year in advance of maturity to give it flexibility and enable it to act quickly in response to  
19 proposals from lenders.

20 8. UNS Electric seeks to issue \$100 million of long-term debt with a maturity date  
21 between five and twenty years. Terms for the loan type and interest rate are yet to be negotiated.

22 Revolving Credit Facility

23 9. Applicants seek to extend the maturity of the existing \$40 million revolving credit  
24 facility, increase the amount of the facility from \$40 million to \$60 million, and to enter into similar  
25 amendments or refinancing to extend the facility during the next three years should favorable  
26 opportunities arise.

27 10. Applicants state that they seek to increase their revolving line of credit facility from  
28 \$40 million to \$60 million to improve access to funds for short-term liquidity and working capital

1 purposes to fund growth. Applicants cite their service areas' four to five percent growth rate and the  
2 need for additional infrastructure as warranting an increase in the amount of the facility. Applicants  
3 assert that conditions in the bank credit markets have improved since they entered into their existing  
4 revolving credit facility and that companies with similar credit profiles are currently receiving more  
5 advantageous rates and reduced commitment fees. Thus, they believe there is an opportunity for  
6 them to obtain reduced pricing and also extend the term of the facility.

7 11. Applicants also state that increased borrowing capacity will facilitate issuing letters of  
8 credit as credit enhancement for energy purchases and for hedging arrangements for UNS Gas.  
9 Applicants state that UNS Gas purchases a portion of its gas supply on a forward basis in order to  
10 hedge against commodity price volatility. In the future, UNS Gas's gas suppliers or financial  
11 counterparties may require credit enhancement in the form of letters of credit. In addition, UNS  
12 Electric's full requirements power purchase contract with Pinnacle West Capital Corporation expires  
13 in 2008 and UNS Electric may be required to provide credit enhancement under future power  
14 purchase agreements.

15 12. According to the application, the applicable borrowing rate as of June 30, 2006, was  
16 the London Interbank Offered Rate ("LIBOR") plus 1.50 percent, and an annual commitment fee of  
17 0.45 percent applied to the unused balance. The facility was amended and restated on August 11,  
18 2006 to provide:

19 The interest rate payable on any borrowings under the facility is LIBOR +  
20 1.00% for Eurodollar borrowings, or at the agent bank's reference rate  
21 (generally Prime Rate) for any Alternate Base Rate ("ABR") borrowings.  
The commitment fee on the unused commitment is 15 basis pts. per  
annum. Previously, these amounts were LIBOR + 1.50 % for Eurodollar  
borrowings and 45 basis pts. for the commitment fee.

22 Any borrowings outstanding at maturity are due and payable at the time.  
23 Interest is payable quarterly for any ABR borrowings, For example, if a  
24 borrower borrowed on a Eurodollar basis for one month, interest would be  
payable at the end of that one month period.

25 The amended agreement extends the maturity date of the facility to August 11, 2011. Under the  
26 revolving credit facility's terms, either UNS Gas or UNS Electric can borrow up to 75 percent of the  
27 total. The obligation of each entity is several and not joint, so neither entity guarantees the  
28 obligations of the other.

1        13. Applicants request authorization to enter into amendments to their existing revolving  
2 credit facility or to refinance by entering into new agreements with an ultimate maturity date in  
3 August 2014. The Applicants assert that such refinancing authority would allow them to take  
4 advantage of opportunities to obtain better terms as they arise in a timely manner.

5 Security Interest

6        14. UNS Electric requests to grant, if needed to complete the financing or to achieve lower  
7 interest rates, a lien on some or all of its properties, including properties acquired after the date of the  
8 grant of the lien, to secure its obligations under the new long-term debt and revolving credit facility  
9 and to secure any other obligations existing at the time the lien is granted which must be secured if  
10 such lien is granted. UNS Gas is not requesting authority to grant liens on its properties.

11 Financial Analysis

12 UNS Electric

13        15. Staff analyzed the effect of the proposed financing request on UNS Electric utilizing  
14 financial statements for the year ended December 31, 2005, and making certain assumptions about  
15 the proposed new loans. Staff's pro forma analysis calculated the effects of a \$100 million loan at  
16 7.61 percent, repayment of the \$60 million Senior Notes and repayment of the \$5 million outstanding  
17 on the revolving credit facility. Staff analyzed the effects of a five-year amortization, six-year  
18 amortization and five-year non-amortizing loan, and factored in the effect of a \$45 million<sup>1</sup> (interest-  
19 only, with balloon payment) revolving credit facility at 6.6 percent.<sup>2</sup> Staff calculated the effect on  
20 capital structure and debt service ratios.

21        16. Times Interest Earned Ratio ("TIER") represents the number of times earnings cover  
22 interest expense on short-term and long-term debt. A TIER greater than 1.0 means that operating  
23 income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long term but  
24 does not mean that debt obligations cannot be met in the short term.

25        17. Debt Service Coverage Ratio ("DSC") represents the number of times internally  
26 generated cash will cover required principal and interest payments on short-term and long-term debt.

27 \_\_\_\_\_  
28 <sup>1</sup> UNS Electric may draw up to 75 percent, or \$45 million of the \$60 million revolving credit facility.

<sup>2</sup> LIBOR plus 100 basis points, as of September 1, 2006, LIBOR was 5.6 percent.

1 A DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations. A  
2 DSC less than 1.0 means that debt service obligations cannot be met by cash generated from  
3 operations and that another source of funds is needed to avoid default.

4 18. Staff's pro forma calculations indicate a TIER of 1.42 and DSC of 0.91, assuming a  
5 five-year amortization period. Staff states that the DSC below 1.0 indicates that December 31, 2005  
6 operating results were not sufficient to meet all obligations under this scenario. Staff further  
7 determined that changing the amortization period to six years on the proposed \$100 million loan  
8 increases the pro forma DSC to 1.04, which indicates that operating results would be sufficient to  
9 meet all obligations. Staff determined also that a non-amortizing loan increases the pro forma DSC  
10 to 1.34. Staff notes that these pro forma TIER and DSC calculations assume there is no repayment of  
11 the outstanding balance on the revolving credit facility or the non-amortizing loan.

12 19. UNS Electric's capital structure at December 31, 2005, consisted of 4.41 percent  
13 short-term debt, 52.36 percent long-term debt and 43.23 percent equity. The pro forma capital  
14 structure resulting from issuance of the proposed \$100 million long-term debt with a six-year  
15 amortization, repayment of the \$60 million existing long-term debt, and drawing of \$45 million on  
16 the revolving credit facility would consist of 3.83 percent short-term debt, 69.76 percent long-term  
17 debt and 26.42 percent equity. Staff believes that the projected highly leveraged capital structure  
18 provides a cautionary signal.

19 UNS Gas

20 20. Staff's analysis of the effect of the proposed borrowing on UNS Gas utilizes  
21 December 31, 2005 financial results and assumes a \$45 million draw down of the revolving credit  
22 facility at 6.6 percent.

23 21. Staff's pro forma analysis for UNS Gas indicates a TIER of 1.73 and DSC of 2.42,  
24 which Staff states shows that operating results are sufficient to meet all obligations. Staff notes the  
25 pro forma TIER and DSC calculations reflect interest payments with no repayment of any debt.

26 22. UNS Gas's capital structure as of December 31, 2005, consisted of 55.56 percent  
27 long-term debt and 44.38 percent equity. The pro forma capital structure, assuming a draw of \$45  
28 million on the revolving credit facility, would consist of 64.5 percent long-term debt and 35.5 percent

1 equity. Staff considers this projected capital structure to be acceptable.

2 Engineering Staff Review

3 23. Engineering Staff concludes that based on review of load growth, outage statistics and  
4 2006-2010 work Plans, the activities contemplated by UNS Electric and UNS Gas in this application  
5 are appropriate and their cost estimates are reasonable. Staff makes no "used and useful"  
6 determination in this proceeding. The rate-making treatment for any plant improvements resulting  
7 from the proposed financing is deferred to a future rate proceeding.

8 Staff conclusions and recommendations

9 24. Staff concludes that the financing transactions as proposed by the Applicants are  
10 reasonable, are within their corporate powers, are compatible with the public interest, would not  
11 impair their ability to provide services and would be consistent with sound financial practices if  
12 subsequent to any debt issuance, common equity represents at least 30 percent of total capital<sup>3</sup> for the  
13 borrowing entity.

14 25. Staff recommends the requested financing be subject to the following conditions:

- 15 a. That the UNS Electric \$100 million long-term debt should be financed for a term not  
16 more than 20 years and if it is an amortizing loan, for a term of not less than 6 years.
- 17 b. That the maximum allowable draw for either UNS Electric or UNS Gas under the joint  
18 \$60 million revolving credit facility should be \$45 million.
- 19 c. That subsequent to any additional debt incurred by UNS Electric or UNS Gas,  
20 common equity represents at least 30 percent of total capital for the borrowing entity.
- 21 d. That any authorization to amend or refinance the revolving credit facility should  
22 terminate on August 11, 2011.
- 23 e. That any amendment or refinancing of the revolving credit facility should not include  
24 a maturity after August 11, 2011.
- 25 f. That any amendments and renegotiations of the revolving credit facility should be  
26 supported by a filing with Docket Control explaining the business rationale for the  
27

28 <sup>3</sup> Measured as consisting of common equity, preferred stock, long-term debt and short-term debt.

1 transaction and a demonstration that the rates and terms were consistent with those  
2 generally available to comparable entities at the time.

3 26. Staff further recommends: (1) authorizing the Applicants to engage in any transactions  
4 and to execute or cause to be executed any documents to effectuate the requested authorizations; and  
5 (2) that the Applicants file with Docket Control within 60 days of any financing transaction  
6 authorized herein a copy of all notes and other documents memorializing the transaction.

7 27. Staff's recommendations are reasonable. Although Applicants have requested  
8 authority to refinance the revolving credit facility with a maturity extended to August 2014, we  
9 believe that Staff's recommendation to limit the maturity date of that facility to August 2011 gives  
10 the Applicants sufficient flexibility. Applicants can file another application for a facility with a  
11 maturity beyond 2011.

12 28. We find further that any future amendments or refinancing under the authority granted  
13 herein, should be conditioned on Applicants obtaining rates and terms that result in net savings to the  
14 Applicants inclusive of all transaction costs.

### 15 CONCLUSIONS OF LAW

16 1. UNS Electric and UNS Gas are public service corporations within the meaning of  
17 Article XV of the Arizona Constitution and A.R.S. §§ 40-301, 40-302, and 40-303.

18 2. The Commission has jurisdiction over UNS Electric and UNS Gas and of the subject  
19 matter of the application.

20 3. Notice of the application was given in accordance with the law.

21 4. As conditioned herein, the financing approved is for lawful purposes within  
22 Applicants' corporate powers, is compatible with the public interest, with sound financial practices,  
23 and with the proper performance by Applicants of service as public service corporations, and will not  
24 impair Applicants' ability to perform the service.

25 5. The financing approved herein is for the purposes stated in the application, is  
26 reasonably necessary for those purposes, and such purposes may, wholly or in part, be reasonably  
27 chargeable to operating expenses or to income.  
28



## ORDER

IT IS THEREFORE ORDERED that UNS Electric, Inc. is hereby authorized to borrow \$100 million at an interest rate not to exceed 7.61 percent per annum and a term not to exceed twenty years, for the purposes set forth in the application and set forth herein.

IT IS FURTHER ORDERED that UNS Electric, Inc. and UNS Gas, Inc. are hereby authorized to increase the amount of their joint Revolving Credit Facility to \$60 million.

IT IS FURTHER ORDERED that the maximum amount either UNS Electric, Inc., and UNS Gas, Inc. may borrow at any one time on the joint Revolving Credit Facility shall be limited to \$45 million.

IT IS FURTHER ORDERED that neither UNS Electric, Inc. nor UNS Gas, Inc. shall issue debt under the authority granted herein if such issuance would cause either entities' equity to be less than 30 percent of its total capital at the time of the issuance or draw.

IT IS FURTHER ORDERED that UNS Electric, Inc. is authorized to grant liens on some or all of its properties to secure its obligations under the new long-term debt and revolving credit facility.

IT IS FURTHER ORDERED that UNS Electric, Inc. and UNS Gas, Inc. are hereby authorized to amend or refinance the revolving credit facility, however, such authority shall be conditioned upon UNS Electric, Inc. and UNS Gas, Inc. obtaining rates and terms resulting in net savings to UNS Electric, Inc. and UNS Gas, Inc. inclusive of all transaction costs, and such refinance or amendment shall not extend the maturity of the facility beyond August 11, 2011.

IT IS FURTHER ORDERED that any amendments and renegotiations of the revolving credit facility should be supported by a filing with Docket Control explaining the business rationale for the transaction and a demonstration that the rates and terms were consistent with those generally available to comparable entities at the time.

IT IS FURTHER ORDERED that UNS Electric, Inc. and UNS Gas, Inc. are hereby authorized to engage in any transactions and to execute or cause to be executed any documents or modifications to existing documents to effectuate the authorization granted herein, including notes and bonds evidencing or securing the indebtedness authorized herein.

1 IT IS FURTHER ORDERED that such finance authority shall be expressly contingent upon  
2 UNS Electric, Inc.'s and UNS Gas, Inc.'s use of the proceeds for the purposes stated in the  
3 application and approved herein.

4 IT IS FURTHER ORDERED that any refinancing transaction pursuant to this authority shall  
5 be subject to review in the first UNS Electric, Inc. and/or UNS Gas, Inc. rate case after the  
6 completion of the transaction.

7 IT IS FURTHER ORDERED that UNS Electric, Inc. and UNS Gas, Inc. shall file with  
8 Docket Control, as a compliance item in this docket, copies of all executed financing documents  
9 within 60 days after the date of execution.

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1 IT IS FURTHER ORDERED that approval of the financing set forth hereinabove does not  
2 constitute or imply approval or disapproval by the Commission of any particular expenditure of the  
3 proceeds derived thereby for purposes of establishing just and reasonable rates.

4 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

5 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

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8 CHAIRMAN

COMMISSIONER

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10 COMMISSIONER

COMMISSIONER

COMMISSIONER

11  
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13 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive  
14 Director of the Arizona Corporation Commission, have  
15 hereunto set my hand and caused the official seal of the  
16 Commission to be affixed at the Capitol, in the City of Phoenix,  
17 this \_\_\_\_ day of \_\_\_\_\_, 2007.

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BRIAN C. McNEIL  
EXECUTIVE DIRECTOR

DISSENT \_\_\_\_\_

DISSENT \_\_\_\_\_

JR:mlj

1 SERVICE LIST FOR: UNS ELECTRIC, INC. AND UNS GAS, INC. COMPANY

2 DOCKET NOS. : E-04204A-06-0493 and G-04204A-06-0493

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